BRIEF IN SUPPORT OF PETITION.

POINT I.

The decision sought to be reviewed appears to conflict with the spirit and intent of this Court's decision in the *United States Realty Company* case, and its subsequent decisions on the point in issue.

Securities and Exchange Commission v. *United States Realty Company*, 310 U. S. 434;
Marine Harbor Properties v. *Manufacturers Trust Company*, 317 U. S. 78.

The three decisions in this case turn upon an interpretation of this Court's opinion in the *United States Realty Company* case, *supra*. The Circuit Court agreed with the Referee that under that decision, the petitioner was barred from seeking relief under Chapter XI of the Bankruptcy Act. The District Court, on the contrary, held that the *United States Realty Company* case was not a bar, and did not require that a fraternal organization, or, for that matter, any corporation similarly situated, to proceed under Chapter X rather than Chapter XI of the Bankruptcy Act.

That there is some doubt on the subject, appears admitted in the opinion of Judge Clark, for he says:

> "On the merits the answer is not as clear cut; but we are of the opinion that the Referee acted

> properly in dismissing the petition in favor of a proceeding under Chapter X * * *. Of course there still is no well-defined answer in the borderline cases to the question as to whether a particular corporation should be permitted to proceed under Chapter XI * * *" (Record, p. 76).

In the *United States Realty Company* case we find that this Court refers, over and over again, to the "public" interest. In that case it was the Securities and Exchange Commission that originally intervened, in order, as this Court said in its opinion "to protect the interests of the public, especially committed to its guardianship under the provisions of Chapter X".

In our case, Securities and Exchange Commission refused to appear, and, insofar as it did appear, stated unequivocally that the "public" was not interested, and evidently did not care to intervene.

That the backbone of the *United States Realty Company* case is that that debtor's affairs were the concern of the public at large, is clear from the many frequent references in the opinion to the "public". Thus "Chapter X * * * is specifically adapted to the reorganization of large corporations whose *securities are held by the public*".

At another part of the opinion, this Court said that the question as to whether or not the procedure to be followed by a debtor should be under Chapter X or under Chapter XI, must be based on "considerations growing out of the *public policy* of the Act".

In a footnote to the opinion, this Court said:

> "The basic assumption of Chapter X and other acts administered by the Commission, is that the investing public dissociated from control or active participation of the management, needs impartial and expert administrative assistance * * *" etc.

The District Court, in its opinion, pointed out a very important word of warning that this Court gave in a consideration of cases of this kind. This Court said (at p. 454):

> "While this means that arrangements of unsecured debts of corporations, like respondent, may not be in the best interests of creditors and feasible under Chapter XI, it does not mean that there is no scope for application of that Chapter in many cases where the *debtor's financial business and corporate structure differs from respondent's*" (Record, fol. 143). (Italics ours.)

In the *United States Realty Company* case this Court had before it a corporation whose financial structure was not only multiple, but extremely complicated. It had secured debts of various kinds. It had unsecured debts. It had stockholders who had invested money in the company and who might benefit in a monetary way by any arrangement effected under the Bankruptcy Act.

Not so here. As the District Court points out:

> "We have here not a business corporation with an involved financial set-up; with different types of creditors. We do have a membership corporation with very little property; with no

> intricate financial set up; *with only one type of creditor* (unsecured bondholders); and with no business or occupation. We are dealing with a fraternal organization for men who hold meetings for their own benefit, socially and fraternally; an organization which has outstanding, unsecured bonds which it cannot pay" (fol. 144).

But, says the Circuit Court in its opinion, the annual income of the debtor is in excess of $50,000, with disbursements of $15,000, and it points out that there is no explanation of the use to which the balance of the receipts is being put.

It seems to us to be unnecessary to require this debtor to go under Chapter X merely for the purpose of obtaining an explanation. Such an explanation, if anyone needed it, can be obtained fully in the proceedings under Chapter XI, on the examination of the debtor's officers, or its books and records. Section 21a of the Bankruptcy Act is quite ample as an instrument of inquiry on any subject pertaining to the acts and property of a bankrupt.

If that were all, then clearly the decision of this Court in the *United States Realty Company* case was misapplied, for we feel certain that it was not intended by this to compel a shifting from Chapter XI to Chapter X, merely because an investigation might be necessary to ascertain the facts regarding the disposition of a debtor's moneys and other property.

This Court's observation in the *United States Realty Company* case that Chapter X is applicable only to corporations of complicated financial structure, is borne out by its subsequent decision in the case of *Marine Harbor Properties* v. *Manufacturers*

Trust Company, 317 U. S. 78. This Court said there:

> "There remains the contention that it was in the 'interests' of the certificate holders to have the proceedings transferred to Chapter X. In this connection much emphasis is placed on numerous safeguards contained in Chapter X, which this Court reviewed in *Securities and Exchange Commission* v. *United States Realty and Improvement Company*, 310 U. S. 434, 438, 450. And it is asserted that comparable safeguards are wholly or largely lacking in proceedings under the Schackno Act. Those considerations would be highly relevant and persuasive if this was a case of the usual reorganization proceeding *dealing with more than one class of securities under the older procedure* which Chapter X was designed to improve and supplant. (See *Securities and Exchange Commission* v. *United States Realty and Improvement Company*, 310 U. S. 448.)" (Italics ours.)

The Circuit Court suggests, in its opinion, that it is probable that many of the members and creditors do not know of the pendency of these proceedings, and that many who have been informed, suffer from a grave lack of accurate information as to the true state of affairs. Then it proceeds to state that for this information the petition under Chapter X is again the only fair solution.

We must respectfully differ with the Court in its conclusion, because its premises are not sound. If it be true that many of the creditors do not know of the pendency of these proceedings, it is because the Referee did not perform his duty to send out notices to all of the creditors giving them the information.

Instead of that, on the very day of the order of reference (July 23, 1943) he entered an order to show cause directed against the petitioner's attorney and the Securities and Exchange Commission, requiring both to show cause why the petition should not be dismissed. Why weren't the creditors notified? It seems to us that they had something to say about it too. At least they should have been informed of the proceedings, and then the criticism suggested by the Circuit Court in its opinion would have been avoided. The mere fact that the creditors did not know, because they were not informed, of the pendency of the proceedings does not, in our opinion, require a petition under Chapter X "as the only fair solution".

In any event, there is nothing in the *United States Realty Company* case even touching on such a reason for a transfer of a case from Chapter XI to Chapter X.

The real purpose of Chapter X, which is an elaboration of the former Section 77b of the Bankruptcy Act, is well set out by Mr. Gerdes in his article on "Corporate Reorganization", 52 Harv. Law Review, p. 1, at p. 5:

> "The petition must now contain a statement as to why adequate relief cannot be obtained under Ch. XI of the Bankruptcy Act, dealing with 'Arrangements', a new procedure substituted for the old composition in bankruptcy *and applying to persons having no secured creditors.* This is intended to make Chapter X unavailable to corporations having simple debt and capital structures whose only purpose in resorting to the reorganization procedure, is to gain by delay temporary advantages for the old management."

(Citing H. R. 12889, 74th Congress, 2 Sess., H. R. 1409, 75th Cong., 1st Sess. (1937), 41.)

It is respectfully submitted that the undisputed facts in this case show that the petitioner has a simple debt involvement. It has no capital structure such as commercial corporations have. Chapter X is unavailable to it by reason of that fact, even though the debt exceeds one million dollars.

In this connection, and bearing on the question of the applicability of this Court's decision in the *United States Realty Company* case, it is pertinent to inquire as to whether the members are real stockholders in the same sense as are the stockholders in the United States Realty Company. The 2800 members of Mecca Temple are stockholders in name only—that name being artificially created for them by the Act. It must be apparent to this Court that the framers of the Act sought to differentiate between individuals and corporations as such, and that in order to give the benefits of the Act to such debtors who were neither individuals, nor corporations in a real sense, they classified as "stockholders" all other members of debtors who are not individuals, but who have a resemblance to corporations. This includes members of unincorporated associations, joint stock corporations, and similar organizations, and, of course, includes fraternal organizations.

But we must look to the realities of each case. Are the members of a fraternal organization *really* "stockholders"? Take this very case of the petitioner before the Court. The evidence is uncontradicted that Mecca Temple began as a membership organization, receiving its charter in 1872 from the Imperial Council. It assumed corporate existence in 1905,

thirty-three years later, under the provisions of law of the State of New York passed in 1896. The only method of assuming corporate existence was by the filing of a certificate indicating the appointment of trustees (Record, fols. 68, 69).

Artificially and legally, Mecca Temple is a corporation (Bankruptcy Act, Sect. 1, subd. 8). Actually, those who are part of it, are *members*, but not stockholders—except insofar as the Bankruptcy Act defines the word "stock" as inclusive of membership in a fraternal organization (Sect. 106, subd. 12).

As members, these men pay dues from year to year. Their right to membership cannot be assigned. It cannot pass by will. It cannot pass under the Decedents' Estate Law of any state. A member may resign, and he loses all rights of fraternal membership. He may default in the payment of dues, with similar result, and, possibly, in rare instances, a member may be dismissed under the by-laws for conduct which may be inimical to the organization.

Can you say the same of a stockholder in a business corporation? Obviously not. A stockholder can sell his stock, and the purchaser takes his place in the corporation. He may bequeath it by will, or, if there is no will, it passes to his heirs-at-law. He cannot, under any circumstances, be deprived of his ownership in the corporation, no matter what his conduct may be.

We point out these considerations, because we feel that in that regard there is a vast distinction existing between a fraternal organization imbued with corporate powers, and a business corporation like the United States Realty Company is, which is a corporation by reason of a subscription to capital stock, and which is the basis of its business life. This Court in

its opinion in the *United States Realty Company* case could not possibly have intended what it said there, of business corporations, to apply to nonbusiness corporations such as Mecca Temple is.

In view of these considerations and the confusion in the concept of corporations which may apply under Chapter XI and which may apply under Chapter X for relief under given circumstances, it is respectfully submitted that this Court never intended that the decision in the *United States Realty Company* case should apply to a case where the debtor has no such capital structure, nor complex financial set-up, and is not organized for profit of its stockholders, and has no secured debts.

It is therefore respectfully submitted that this Court should grant the writ so that it may explain, or limit, or define its decision in the *United States Realty Company* case, with the object in view of avoiding confusion in the various District Courts where possibly, fraternal organizations, hospitals, charitable institutions, or similar bodies corporate in form seek relief under Chapter XI, rather than Chapter X.

POINT II.

The Court below has decided an important question of Federal law which has not been, but should be, settled by this Court.

A reading of the opinion of the Circuit Court would seem to indicate that it has disregarded the fact that Mecca Temple has no secured creditors and that its debts are wholly due to unsecured creditors. Moreover, and in this connection, it has de-

cided that the members of Mecca Temple, like stockholders in a business corporation, should be required to have their interest in the assets of the debtor curtailed to compensate the losses of the bondholders (Record, p. 78). This view is given on the basis of the *United States Realty Company* case, and which in turn relies on the rule in *Northern Pacific Railway Company* v. *Boyd*, 228 U. S. 482, as applied in *Case* v. *Los Angeles Lumber Products Company*, 308 U. S. 106.

The opinion gives this as another reason for reversing the holding below (Record, p. 78).

It is true that the *United States Realty Company* case pointed out that, in that case, the stockholders should be required to curtail their own rights in the assets, and for that reason corporate reorganization under Chapter X, and not an arrangement under Chapter XI was the proper remedy.

But this Court did not have before it a case where the stockholders were such in name only, and where there was no capital at all, and where the only assets in which the 2800 members could share, even if you call them "stockholders", were cemetery lots of no value, a minute share or interest in real estate which gave an income of some $1300 a year, and the usual paraphernalia of a Masonic organization.

Now, what rights could members surrender in a fraternal organization that are equivalent to rights which could be surrendered by stockholders in a business corporation? Could a member of Mecca Temple give up part of his membership to the bondholders? Could he surrender his right to be buried in the cemetery? Could he give up any share of the minute interest in the two parcels of real estate?

In accordance with the realties of the situation,

what would these members of Mecca Temple be confronted with if they were required to proceed under Chapter X? They would be confronted with an impossible situation. Many, if not all, would resign their membership rather than "reorganize" under compulsion. Being a voluntary membership organization, these members could just as voluntarily depart from that membership, either by a written resignation, or by a failure to pay dues. Just how would such procedure benefit bondholders?

On the other hand, where a debtor is a commercial corporation, its stockholders, being vitally interested in safeguarding moneys invested by them as capital in the corporation, could be required to surrender part of that interest in order to save the balance. This is what this Court undoubtedly intended to rule in the *United States Realty Company* case. We cannot believe that this Court intended to have that ruling apply to a fraternal organization such as Mecca Temple is—because it could not apply as a matter of fact.

We therefore respectfully point to this as another reason for granting the writ. We feel that in doing so, and in reviewing the decision of the Court below, this Court will be enabled to extend, or limit, the ruling it made in the *United States Realty Company* case, so as to define more clearly the limitations placed upon debtors who seek relief under Chapter XI as distinguished from those required to seek relief under Chapter X.

POINT III.

The ruling of the Circuit Court is novel, since it applies to fraternal organizations which have no capital even though corporate in form. For that reason this Court should grant the writ and consider and decide the question at issue.

Nowheres in the books do we find any similar ruling on the necessity for applying for relief under Chapter X by fraternal organizations who have no secured indebtedness, and no capital structure.

Without the necessity of repeating the novel facts and the reasons for our position which we have already discussed in the preceding two points, we respectfully ask the Court to consider them in connection with the point we make now. We believe the decision is a novel one, when applied to fraternal organizations.

This is particularly so in view of the ruling in the Circuit Court of Appeals, for the Fourth Circuit, in the case of *Hoile, et al.* v. *United Life Insurance Company,* 136 F. (2) 133 (May, 1943), which holds that an *involuntary* petition for corporate reorganization may not be filed as against a fraternal organization. If that be so, then the question arises whether a fraternal organization can be compelled to file a petition under Chapter X voluntarily. The objective of both petitions would be the same, to-wit, a reshuffling of the secured and unsecured debts. If it cannot be done involuntarily, we believe that this Court ought to consider the question as to whether *voluntary* petitions for reorganization should be compelled by forcing

proceedings under Chapter X on the part of fraternal organizations such as the petitioner is.

For that reason too we respectfully submit this Court should grant a writ of certiorari in this case.

POINT IV.

On the question of the right of the Referee *sua sponte* to initiate the proceedings for dismissal, there is conflict between the Circuit Court in the Second Circuit and the Seventh Circuit on this point of practice.

In the Matter of Frank E. Walsh, 256 Fed. 653 (CCA 7).

It will be recalled that, immediately upon the reference by the District Court to Referee Stephenson, he initiated the proceedings for a dismissal by an order to show cause. No party in interest filed any petition upon which that order to show cause was based. Protest against such procedure on behalf of the debtor proved of no avail. The District Court questioned the right of the Referee to proceed in this manner, but did not base its decision of reversal upon it (fols. 142, 143). The Circuit Court considered the matter and said that he had such power (Record, p. 75).

Now, it should be observed that the Referee himself, as well as the District Court, pointed out that this does not involve the question of jurisdiction in the sense of no power at all to pass on the subject. Indeed, the Referee stated in his opinion "This is not a question strictly of jurisdiction * * *" (fol. 137).

Unlike the *Ettinger* case, 76 Fed. (2) 74, cited by the Referee (fol. 114) there is no claim that the debtor imposed upon the Court, or that the pleadings themselves disclosed lack of jurisdiction as in the case of *Metcalf* v. *Watertown,* 128 U. S. 586.

The point made by the debtor's counsel was that the Referee *had a duty of going forward* in accordance with the order of reference, even though it might develop later that a creditor might protest against the proceedings. While no protest was lodged in the *U. S. Realty Company* case by a creditor, nevertheless it was lodged by the Securities and Exchange Commission, as intervenor representing the public.

It is our contention that the Referee could not act *sua sponte* in the manner in which he did. He could not be a movant and a judge at the same time. We have been overruled on that point in this case.

We therefore respectfully call the Court's attention to a somewhat similar situation in which the ruling was otherwise. In the case of *Matter of Frank E. Walsh,* bankrupt, decided by the Circuit Court of Appeals for the 7th Circuit, 256 Fed. 653, the question arose as to whether the Court could, of its own motion, file objections to a discharge. The Court held that it could not in the following language:

> "Nor should the Court on its own motion interpose objections to the discharge, for courts do not create issues. They sit to try and determine them upon presentation of the evidence by the parties interested."

We believe we have an exactly similar situation presented here which requires a final ruling by this

Court. Mecca Temple was within its rights in applying for relief under Chapter XI. If its procedure under Chapter XI was detrimental to the interests of the creditors, it was the privilege of any creditor to say so. Or, if the public was interested sufficiently to justify it, Securities and Exchange Commission could intervene and say so, as it did in the *Realty Company* case.

We do not conceive it to be the duty of a Referee, on his own motion, to require the parties to show cause why a petition, regular on its face, should be dismissed.

The Referee becomes the moving party. He also sits as a judge on his own motion. As a judicial officer on a motion of this kind, he is required to pass on facts as well as law, yet he offers no proof in support of his own motion brought before himself as a judge.

Stated in this way, the situation seems to be a rather difficult one, and contrary to orderly judicial procedure. Such practice has been condemned in the Seventh Circuit. Under the circumstances, this Court is respectfully asked to consider and decide whether the ruling laid down in the Seventh Circuit is correct, or whether the ruling laid down in this case in the Second Circuit, is correct, with regard to this kind of practice.

CONCLUSION.

Since the decision below is predicated almost wholly on the *United States Realty Company* case, it is respectfully submitted that the *Mecca Temple* case, differing in its essential facts from the *United States Realty Company* case, justifies the issuance of a writ of certiorari to the Circuit Court of Appeals for the Second Circuit. If not that, then the conflict in point of practice between the Seventh Circuit and the Second Circuit requires the issuance of the writ of certiorari.

Respectfully submitted,

DAVID HAAR,
Attorney for Debtor-Petitioner.